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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

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UNION PACIFIC'S OPENING COMMENTS ON PROPOSED MERGER RULES

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**UNION PACIFIC'S OPENING COMMENTS
ON PROPOSED MERGER RULES**

Union Pacific Corporation and Union Pacific Railroad Company (collectively "UP") appreciate this opportunity to comment in response to the Board's Notice of Proposed Rulemaking ("NOPR"). The NOPR would revise the Board's merger rules to reflect the dramatic changes that have occurred in the rail industry since the existing rules were adopted two decades ago. Although the Board's proposed rules update the criteria for reviewing potential merger proposals, UP has significant concerns about a number of components of the proposed rules. UP joins in the comments of the Association of American Railroads ("AAR"), which address several of these topics.

In these Opening Comments, we describe UP's additional concerns and offer several suggestions for changes in direction or further refinement. We present UP's comments in the order of the topics listed in the Board's Advance Notice of Proposed Rulemaking, served March 31, 2000. For each topic, we review UP's initial positions,[1] summarize the Board's proposals in the NOPR, and offer comments and suggestions.

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1 We attach as Appendix A "Union Pacific's Comments and Initial Proposals," filed May 16, 2000 in response to the Advance Notice of Proposed Rulemaking. This document contains the full text of UP's initial recommendations in this proceeding.

I. Downstream Effects

UP's Initial Position. UP endorsed the Board's commitment to consider the downstream effects of future major rail mergers. In its May 16, 2000 Comments and Initial Proposals (Appendix A), UP offered suggestions for implementing this commitment. UP warned that parties cannot realistically evaluate the effects of specific downstream Class I mergers because there are too many possible permutations. It therefore recommended that the Board require applicants to "evaluate the effects on competition and the public interest of combining all Class I railroads in the United States and Canada into two North American Class I railroads." Appendix A, p. 26. UP also proposed a rule requiring procedural consolidation of major merger applications filed contemporaneously. Id.

Proposed Rules. The Board's proposed rules would require merger applicants to address potential downstream effects of their proposal by predicting the specific transactions that others will propose in response. See proposed §§ 1180.1(i), 1180.6(b)(12). Proposed § 1180.6(b)(12) requires applicants to "anticipate what additional Class I merger applications are likely to be filed in response to their own application and explain how, taken together, these applications could affect the eventual structure of the industry and the public interest." The Board might impose additional conditions in the future if downstream mergers occur. Proposed § 1180.6(b)(12)(ii). The rules would require that applicants, "[w]hen calculating the likely public benefits that their merger will generate, . . . measure these benefits in light of the anticipated downstream mergers." Proposed § 1180.1(i).

UP's Comments. UP again endorses thorough consideration of downstream effects in future merger cases. As the Board has found, the next major merger is likely to lead to creation of two transcontinental railroads. NOPR, p. 8. Before approving another major rail merger, the Board should determine whether this final round of railroad consolidations is desirable. Presumptively, this will be the central public policy issue in a future Class I merger proceeding.

a. Specific transactions

UP respectfully suggests that the focus on specific downstream mergers is misguided and requires predictions that no one can reliably make. Predicting how half a dozen large railroads will respond to a future merger proposal calls for excessive speculation. Even if a downstream merger of Railroads A and B seems logical, there is no assurance that the two railroads could negotiate an agreement. Moreover, the A-B merger will involve unpredictable voluntary conditions to address competitive concerns. How many people could have guessed in 1995 that UP and SP would negotiate more than 4,000 miles of trackage rights with BNSF and open up the I-5 Corridor to single-line competition? The Board's call for predictions of specific transactions therefore creates a high likelihood that applicants will make inaccurate guesses and that both the applicants' and the Board's merger analyses will miss the mark. Requiring applicants to calculate the financial benefits of these predications adds only an illusion of concreteness to the guesswork.

The Board's proposed rules demand unrealistic precision, while allowing applicants to avoid addressing the important public policy questions presented by a major rail merger. By allowing applicants to identify only downstream transactions that are "likely," the proposed rules leave applicants free to deny that any downstream merger is sufficiently likely to deserve study. Even though the evidence in this rulemaking already establishes that the next Class I merger is likely to trigger an "end game" that results in only two transcontinental railroads, the Board's proceeding might not address the impact of that end game on the public interest.

For example, if CN and NS were to plan a merger, they and other parties might reasonably assume that CSX and CP would follow suit in a mirror-image downstream merger. That guess could easily be mistaken, though, as there are many possible alternatives. For example, BNSF might mount a strategic acquisition of CSX. Building a public interest analysis, computing benefits, and designing conditions on the assumption of a downstream CSX-CP merger would be a waste of everyone's time if BNSF then acquired CSX. Meanwhile, the important questions associated with another wave of railroad mergers could go unanswered.

UP therefore urges the Board to revise its proposed rules to require a thorough evaluation of the implications of the two-railroad scenario in the manner proposed in Appendix A, pp. 25-26.

b. <u>"Springing" conditions</u>

The Board should not attempt to remedy the effects of downstream mergers by designing conditions that would spring into effect when a downstream merger occurs. The Board cannot impose post-merger conditions on transactions that have already been consummated unless it provides sufficient notice in its approval decision about those conditions. The Board will be unable to do so here. No one can predict with accuracy which specific downstream mergers are most likely to follow a proposed merger, much less how those downstream mergers will be designed and what settlements the applicants will propose. Any attempt to specify springing conditions in advance is doomed to fail. As a result, applicants would be unable to evaluate the costs and benefits of a proposed merger because they would not know what conditions the Board might eventually adopt in response to a later merger. The Board's final decision regarding any merger must specify all conditions applicable to that merger.[2]

It is settled law that the Board cannot impose new regulations and conditions on consummated mergers, just as the Board cannot apply its proposed merger rules on railroad mergers consummated before the rules are adopted.[3] The Administrative Procedure Act[4] and fundamental principles of due process limit the Board's authority to apply new rules or new conditions retroactively. Retroactive application of new rules "would impair the rights a party possessed when he acted, increase a party's liability for past conduct, or *impose new duties with respect to transactions already complete*." Landgraf v. USI Film Products, 511 U.S. 244, 280 (1994) (emphasis added). Thus, any rule formulated in this proceeding can only have future effect. See 5 U.S.C. § 551(4) (defining a rule as "the whole or a part of an agency statement of general or particular applicability *and future effect* designed to implement, interpret, or prescribe law or policy or describing the organization,

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2 The Board should, of course, conduct oversight proceedings to ensure that those conditions achieve their goals and may modify conditions as necessary to ensure their effectiveness.

3 The Board's NOPR recognizes that the proposed rule changes would apply only to "future major railroad merger proposals." NOPR, p. 9. It is appropriate for the Board in a future merger case to examine whether the proposed merger adversely affects competition that was protected or enhanced by conditions imposed in a prior case. The Board can impose conditions on future mergers to protect that competition. For example, the ICC in the UP/MKT case required UP to reach an agreement substituting a new carrier with respect to the "North End" rights between Kansas City and Omaha/Council Bluffs that were granted to MKT in the UP/MP/WP merger. Union Pac. Corp., Union Pac. R.R. & Missouri Pac. R.R. – Control – Missouri-Kansas-Texas R.R., 4 I.C.C.2d 409, 452-58 (1988). Any attempt to apply the Board's new rules retroactively to a transaction approved prior to their adoption, however, would be unlawful.

4 Ch. 423, 60 Stat. 237 (current version at 5 U.S.C. §§ 551-559, 701-706).

procedure, or practice requirements of an agency . . . .") (emphasis added). The Supreme Court made this clear in Bowen v. Georgetown University Hospital, 488 U.S. 204, 208 (1988), when it stated that "a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms." Congress did not authorize the Board to use its merger authority to impose new substantive obligations on parties that chose to consummate a merger in light of the specific conditions imposed by the Board. To the contrary, the statute indicates that the Board has authority to condition a proposed transaction only in the context of deciding whether to approve that transaction, not thereafter. See 49 U.S.C. § 11324(c).

In future merger proceedings, the Board is unlikely to be able to specify downstream conditions with sufficient particularity to avoid violating these fundamental principles of due process. The rail industry's crystal ball is not clear enough to predict accurately the sequence of downstream transactions or how those transactions will be designed, much less to craft conditions appropriate for every permutation. Applicants cannot plan or implement mergers under the risk that an unanticipated future merger will cause the Board to impose major changes on an approved merger. The Board must identify all necessary conditions when it considers a proposed transaction so that the parties can understand what will be required of them when they decide to consummate.

II. Maintaining Safe Operations

UP's Initial Position. UP observed that the Board's safety compliance programs, administered in conjunction with FRA, are effective. Appendix A, pp. 26-27.

Proposed Rules. Pending completion of its joint rulemaking with FRA in Ex Parte No. 574, the Board would require merger applicants to work with FRA on a case-by-case basis to formulate Safety Integration Plans. Proposed §1180.1(f)(2). The Board also proposes that applicants submit evidence about potentially blocked grade crossings resulting from merger-related traffic increases. Id.

UP's Comments. UP respectfully suggests that the Board's request for evidence on grade crossing blockage reflects the wrong approach. Instead of seeking evidence on blocked crossings, the Board should require applicants to plan adequate capacity to handle merger-related traffic increases without creating new blocked street crossings. In any event, the rule will not generate useful evidence. No merger applicant will plan to create congestion and block crossings.[5] Thus, UP asks the Board to withdraw this additional evidentiary requirement.

III. Safeguarding Rail Service

UP's Initial Position. UP proposed three measures to ensure that future mergers do not lead to transitional service disruptions: more detailed and realistic implementation planning, development of a service database that would permit objective comparisons between pre- and post-consolidation service, and remedies for post-consolidation deterioration in service. Appendix A, pp. 27-31.

Proposed Rules. The Board's proposed rules address service concerns by requiring applicants to prepare Service Assurance Plans that "identify the precise steps to be taken by applicants to ensure that projected service levels are attainable and that key

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5 In implementing the UP/SP merger, UP found that its trains blocked grade crossings only because of unexpected congestion.

elements of the operating plan will improve service."[6] The Board further proposes that it "will conduct extensive post-approval operational monitoring to help ensure that service levels after a merger are reasonable and adequate."[7] It proposes no remedial mechanism for service failures.

The Board also strongly encourages applicants to negotiate private agreements with shippers and connecting railroads to address service concerns. Urging "applicants to engage in good faith negotiations with shippers and connecting carriers" in order to provide "specific service assurances," the Board emphasizes that "[t]he extent to which applicants are successful in such negotiations would be an important consideration in our determination as part of the balancing process of the likelihood of merger-related service harm and the possible need for mitigation." NOPR, p. 20.

UP's Comments.

a. Service data

To support its monitoring efforts, the Board should require applicants to be able to show whether service has improved or deteriorated. Monitoring requires consistent data. During its service crisis in 1997-98, UP and its customers found that their data were often in conflict due to differing sources of data and ways of measuring service. UP continues to believe that requiring merging carriers to develop and retain data on pre-consolidation service levels would be of considerable value to the Board and affected parties in evaluating service following a consolidation.

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6 Proposed § 1180.10

7 Proposed § 1180.1(h)(2).

b. Bilateral agreements

UP is concerned that the Board's emphasis on bilateral agreements as a mechanism for addressing service failures may distort the record in merger proceedings. We agree with AAR that pressing applicants to use such agreements gives shippers undue leverage in negotiating agreements. Moreover, as we previously pointed out, confidential bilateral agreements between merger applicants and their shippers tend to involve an exchange of valuable concessions for support for the merger. The concessions induce the shipper not to reveal competitive concerns and to endorse merger benefits that it may not consider valuable. Such agreements can also commit the merged system to change its operations, altering the balance of benefits and harms in ways important to the Board's consideration of the transaction. UP believes that these agreements mislead the Board and the public.

If the Board insists on encouraging these agreements, it should require applicants to disclose the agreements to the Board and participants in the merger proceeding, subject to appropriate confidentiality protections. The transaction presented for Board approval must include all commitments that are contingent on merger implementation and designed to influence the position taken by a shipper, connecting railroad, or governmental body. See CN/IC,[8] Decision No. 37, served May 25, 1999, p. 33 (holding that CN/IC-KCS Access Agreement was "clearly merger-related because: it does not become effective unless and until the consolidation is approved" and was "entered . . . to enlist KCS's support for the

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8 STB Finance Docket No. 33556, Canadian Nat'l Ry., Grand Trunk Corp., & Grand Trunk W. R.R. – Control – Illinois Cent. Corp., Illinois Cent. R.R., Chicago, Cent. & Pac. R.R. & Cedar River R.R.

merger"); Decision No., 31, served Feb. 12, 1999 (requiring disclosure of agreements). The Board and participants need to know if the applicants have made commitments that might burden applicants' post-merger operations, disadvantage connecting railroads, alter competitive balances, or deter applicants from taking pro-competitive actions, as the Board found to be the case with respect to the CN/IC Access Agreement. Accordingly, the Board should adopt a rule requiring disclosure of all commitments made by merger applicants in connection with a pending merger application.

IV. Promoting and Enhancing Competition

UP's Initial Comments. UP encouraged the Board to promote competition in its merger rules but also urged the Board not to use its jurisdiction over mergers to "alter the competitive structure of the rail industry other than to address the effects of a merger." Appendix A, p. 31. UP proposed a new rule that would address the principal concern raised by shipper organizations about the competitive effects of "end-to-end" mergers: that such mergers might adversely reduce shippers' routing options and their opportunities to challenge freight rates by closing gateways such as New Orleans, St. Louis or Chicago. UP proposed a condition requiring applicants to maintain separately challengeable "bottleneck" segment rates for movements between exclusively served shipper facilities and established gateways affected by the merger. Id., pp. 32-35.

Proposed Rules. The Board's proposed rules address competition issues in several ways. First, many of the Board's proposed rules promote a philosophy that future mergers must "not simply preserve but also enhance competition." E.g., proposed § 1180.1(d). Second, the Board would require applicants to propose specific conditions that will enhance competition and cautions that, "[u]nless merger applications are so framed, approval of proposed combinations where both carriers are financially sound will likely cause the Board to make broad use of the powers available to it . . . to condition its approval to preserve and enhance competition." Proposed § 1180.1(c). Third, the proposed rules require preservation of gateways:

> Applicants shall also explain how they would at a minimum preserve competitive options such as those involving the use of major existing gateways . . . and the opportunity to enter into contracts for one segment of a movement as a means of gaining the right separately to pursue rate relief for the remainder of the movement.

Proposed § 1180.1(c)(2)(i). The Board explains that this rule requires applicants to present an "effective plan" to keep open "major existing gateways" and preserve shippers' opportunities to challenge rates. NOPR, pp. 15-16.

UP's Comments.

a. Enhanced competition

UP agrees with AAR that the Board went too far in requiring competition-enhancing concessions that do not address specific anti-competitive effects of a proposed merger. The proposed rules instruct applicants to propose changes to industry structure that will enhance competition and warn that the Board will impose such changes if applicants do not. The Board grounds this fundamental change in merger policy on its assumptions that future mergers will adversely affect competition in ways that cannot be remedied and that mergers will cause temporary service disruptions. The first assumption is unwarranted; anti-competitive effects can be identified and should be corrected. The second assumption, even if true, would not justify permanent structural changes in rail competition. UP shares AAR's concern that the Board's proposed rules would cause merger proceedings to become battlegrounds over open-ended restructuring of the rail industry unrelated to the effects of the proposed transaction.

The Board should give merger applicants credit for all proposals that enhance competition. Applicants usually identify enhancements to competition in their applications, and some of those improvements are broader than remedies for competitive harms. For example, UP's agreement with BNSF in the UP/SP proceeding to create two competing rail routes in the West Coast's Interstate 5 Corridor created competition that had never before existed. The Board should not, however, impose new competition on a merger. If competitive harms cannot be addressed and are not offset by sufficient public benefits, the Board should reject the merger.

b. Open gateways

UP agrees with the thrust of the Board's proposal but believes that it does not provide sufficient guidance to potential applicants about what constitutes an "effective plan" for preserving established routes. The Board's proposed rules instead defer developing substantive standards for this rule until the next merger case. UP recommends that the Board consider establishing specific protection for gateways along the lines proposed by UP in Appendix A, pp. 33-34.

V. Shortline and Regional Railroad Issues

UP argued that all of the concerns expressed by shortline and regional railroads could be addressed in the Board's general rules addressing competition and service issues. Appendix A, pp. 36-37. UP notes that the Board's proposed rules appear to adopt this approach. UP also joins AAR's comments addressing shortline and regional issues.

VI. Three-to-Two Issues

UP's Initial Comments. UP asked the Board to affirm that the Board will evaluate on a case-by-case basis the effects of transactions that reduce the number of rail carrier alternatives from three to two. Appendix A, pp. 37-38.

Proposed Rules. Although the Board did not adopt UP's suggested language, its proposed rules appear to recognize that each "3-to-2" reduction in the number of railroads serving a shipper or corridor deserves separate consideration.

UP's Comments. UP believes that one sentence of the Board's proposed rules should be clarified. Proposed § 1180.1(c)(2)(i) states that "intramodal competition is reduced when two carriers serving the same origins and destinations merge." This sentence could be misinterpreted as establishing a hard-and-fast rule that every reduction in the number of serving carriers will be deemed anticompetitive. The industry's experience and Board precedent establish that this is not true because two rail competitors can continue to provide vibrant competition. UP asks the Board to clarify that competition "may be" reduced in these circumstances, not that it always "is" reduced.

VII. Merger-Related Public Interest Benefits

UP's Initial Comments. UP urged the Board to establish a higher threshold for claims of public benefits. Appendix A, p. 38. We asked the Board to credit as public benefits only those benefits that "applicants demonstrate are incremental to the benefits that could practicably be achieved through means other than a major transaction." Id., p. 39. If benefits can reasonably be achieved without a merger, they are not merger benefits. UP also proposed that the Board weigh current and potential benefits that would be lost if the transaction proceeded. Id., pp. 39-40.

Proposed Rules. Proposed § 1180.1(c) states that, "[w]hen evaluating the public interest, the Board will also consider whether the benefits claimed by applicants could be realized by means other than the proposed consolidation." The proposed rule also notes that "private sector initiatives" other than mergers "can produce many of the efficiencies of a merger while risking less potential harm to the public."

The Board's proposed rules press a merged carrier to achieve every projected benefit of their proposed transaction. The rules require a careful calculation of the net public benefits of the transaction. Proposed § 1180.1(c)(1). To ensure that applicants have no incentive to exaggerate these projected benefits, "the Board expects applicants to propose additional measures that the Board might take if the anticipated public benefits fail to materialize in a timely manner." Id. Finally, the merged carrier must show in the oversight phase that "the merger benefit projections accepted by the Board are being realized in a timely fashion." Proposed § 1180.1(g). Combined, these provisions suggest that the Board will require a merged carrier to achieve each and every projected benefit of its merger and impose "additional measures" if those benefits are not realized in a timely manner.

UP's Comments. UP is concerned that the Board's new rules, which require applicants to guarantee that every projected benefit is realized, would impose unrealistic and counterproductive constraints on implementation of future mergers. UP agrees that merger applicants should not exaggerate the benefits of their proposed transaction and that they should be required to undertake reasonable efforts to carry out their transaction in a manner that achieves the benefits they projected. But the Board should not inflexibly require a merged carrier to carry out every element of its plans.

The transportation environment is dynamic, and merging railroads need the flexibility to adapt to changing conditions while implementing their transaction. The national economy changes, demand for rail transportation fluctuates, customer requirements change, and traffic patterns shift. These changes and many others may make it impossible or imprudent to implement each specific step in the merger application.

Moreover, a merged entity obtains complete knowledge of the system only with experience. As the merger proceeds, railroad managers gain valuable experience that enables them to improve the plans formulated while preparing the merger application. The operating, marketing, and technology plans in an application are prepared months before a merger application is filed and cannot reflect the dynamics of a rapidly changing marketplace. Those plans may become even more outdated over the multi-year course of merger implementation.

Undue rigidity in the oversight process would prevent railroads from serving the public interest. If a railroad must follow every detail of its merger operating plan, it may be forced to forgo more valuable opportunities in favor of those benefits specifically identified in the application. For example, a surge in grain traffic through a port may make it more important for the railroad to invest in grain cars and to add track capacity at the port than to pursue a merger project. If the value of an unanticipated new opportunity exceeds the advantages of a project in the merger application, the higher-value project will provide greater public benefits. The Board's rules should encourage this flexibility.

UP's experience in implementing the UP/SP merger is illustrative. When UP began to absorb the SP system, it found that it could generate greater public benefits by directing its investment dollars in unanticipated ways rather than following the merger application in every particular. For example, the UP/SP application envisioned that UP would spend $38 million to upgrade SP's classification yard in Roseville, California.[9] After

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9 Finance Docket No. 32760, Union Pac. Corp., Union Pac. R.R. & Missouri Pac. R.R. – Control & Merger – Southern Pac. Rail Corp., Southwestern Ry., St. Louis Southwestern Ry. & Denver & R.G.W. R.R., UP/SP-24, Railroad Merger Application, p. 27.

the merger, UP determined that it could provide improved, more efficient service throughout the West by redirecting investment capital from other projects to completely reconstructing Roseville Yard at a cost of $143 million. Among its benefits, the rebuilt yard supports more reliable service for forest products moving from the Pacific Northwest to the Southwest and guaranteed service for perishables moving from California to the eastern half of the nation. Similarly, the UP/SP application projected an $86.6 million investment to improve UP's Kansas Pacific ("KP") line between Denver and Kansas City.[10] After the merger, UP concluded that it should spend over $300 million to upgrade the UP line to support Colorado and Utah coal traffic originating on former SP lines. The benefits of this investment might have been lost had the Board's merger rules and oversight process constrained UP to spend its limited capital as predicted in a merger application prepared in 1995.

Changing economic conditions, such as a severe recession or the failure of new traffic to materialize as expected, might render proposed merger benefits economically unjustified. In these circumstances, strict adherence to achieving specific merger benefits in a timely fashion, as the Board's proposed rules appear to require, could compel carriers to invest scarce resources on investments that the market will not support.

The Board should bear in mind that merging railroads have strong incentives to achieve the maximum possible benefits from their transaction. After all, the applicants pursued the transaction because it offered profitable commercial opportunities. Although the Board should test benefit claims for reasonableness and ensure that benefits are merger-related, the Board can rely on competitive forces and the railroads' strong incentives to

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[10] Id., p. 23.

maximize profits to compel the railroads to implement their merger effectively.

Accordingly, the Board should modify its proposed rules to allow flexibility in implementing a merger. Rather than imposing further conditions if projected benefits are not achieved in a timely fashion, the Board should acknowledge that applicants will fulfill their obligations if they act reasonably to adapt their merger plans to changing conditions. UP recommends that the Board add two new sentences to proposed § 1180.1(g) as follows:

> *The Board recognizes, however, that applicants require the flexibility to adapt to changing circumstances and that it is inevitable that their merger will not be implemented in precisely the manner anticipated in the application. Applicants therefore satisfy their obligation by demonstrating that they acted reasonably in light of changing circumstances.*

The Board should clarify and strengthen its proposed rules in one additional respect. Rather than merely considering whether a proposed benefit could be achieved through cooperation and without consolidation, the Board should make clear that only benefits that require a merger will be considered benefits of the merger. The Department of Justice uses this approach, which should now apply to large railroad mergers. With fewer Class I railroads, cooperation is much more feasible than in the past.

VIII. Cross-Border Issues

UP originally proposed that the Board require that applicants proposing cross-border mergers submit "full system" competitive analyses and operating plans. Appendix A, pp. 40-41. The Board's proposed rules appear to be consistent with that position. See proposed §§ 1180.1(k), 1180.7(b), 1180.8(a).

CONCLUSION

The proposed rules reflect the significant changes in the industry since the existing rules were adopted in the early 1980s. The rules, however, require substantial revision and refinement as described here and in the comments submitted by AAR.

Respectfully submitted,

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November 17, 2000

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 17th day of November, 2000, a copy of the foregoing "Union Pacific's Opening Comments on Proposed Merger Rules" was served by regular mail, postage pre-paid, or a more expeditious manner of delivery on all parties and non-parties of record to this proceeding.

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Appendix A

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UNION PACIFIC'S COMMENTS AND INITIAL PROPOSALS

Union Pacific Corporation and Union Pacific Railroad Company (collectively "UP") appreciate the opportunity to offer comments in response to the Board's Advance Notice of Proposed Rulemaking served March 31, 2000 (the "ANPR").

As the comments in Public Views on Major Rail Consolidations establish, the Board's policies and rules regarding Class I rail mergers[1] must be revised. The Board's current rules are based on the outdated assumption that the railroad industry suffers from excess capacity -- a condition that no longer exists.[2] The shipping community's broad hostility toward additional mergers under current policies and regulations underscores the need for this revision.

UP questions whether additional Class I consolidations will ever be in the public interest, even though mergers have provided important benefits in the past.

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[1] We use the term "merger" to refer to mergers and other forms of consolidation and changes of control involving Class I rail carriers that are treated as "major transactions" under the Board's merger rules.

[2] As UP urged in its Comments in Ex Parte No. 582, the Board should strike from its rules the outdated first two sentences of 49 U.S.C. § 1180.1(a).

They helped eliminate the excess capacity that pre-Staggers Act regulation had forced the railroads to maintain. They combined traffic flows onto fewer routes and via fewer interchanges, allowing railroads to take advantage of economies of density. They helped the railroads achieve major productivity gains, many of which were passed along to shippers in the form of lower rates. And they provided homes for financially weak railroads that had little or no prospect of remaining viable on their own, including the Western Pacific, M-K-T, and Southern Pacific railroads.

Today the Board and stakeholders in rail transportation confront new realities that require a paradigm shift in the way we think about these mergers. The process of eliminating large-scale excess capacity in the rail industry is mostly complete. With far fewer railroads interacting, the opportunities for cooperation to achieve benefits traditionally ascribed to mergers are brighter than ever. For example, studies suggest that alliances are both increasing popular in American business and provide better returns on investment than mergers. Technology is about to alter this 165-year-old industry. More than one railroad has said publicly that e-commerce will "revolutionize" the railroad industry. Most important, additional Class I mergers would likely result in only two major railroads north of the Mexican border.

UP encourages the Board to develop policies and rules that are appropriate for considering merger proposals in this new environment. The Board should evaluate the impact of and need for any additional Class I mergers on the assumption that any such merger is part of an "end game" resulting in transcontinental mergers and only two major railroads in North America. It should condition any mergers it approves in a manner that protects the public interest and shipper interests under that industry structure. Only by adopting this perspective can the Board develop realistic and consistent public policies.

UP will propose and discuss several potential rule changes designed to respond to some of the concerns its customers voiced in the Ex Parte No. 582 proceeding and to adapt the Board's rules to the prospect of transcontinental and trans-border mergers. Our proposals are detailed but should be considered as only initial concepts for further discussion. We expect to revise or reconsider them in response to comments from other parties.

UP discusses its proposals in the order of the topics listed in the ANPR, not in order of their importance.

I. Downstream Effects

When Burlington Northern Santa Fe and Canadian National notified the Board of their consolidation plans, the Board quickly recognized that their transaction would lead to "downstream" effects, including responsive merger applications likely to yield only two remaining North American rail systems. It promptly suspended the "one case at a time" rule set forth in 49 C.F.R. § 1180.1(g). Under the Board's ruling, parties in a BNSF/CN proceeding would have been expected to consider downstream effects.

UP believes the Board acted wisely, and it encourages the Board to impose the same requirements on all proposed Class I merger proposals. Any combination among the six largest remaining railroads in North America would be part of and would drive what many parties at the Board's public hearing described as the "end game" in rail consolidations. Before approving any additional Class I merger, the Board should consider whether the "end game" is in the public interest. This is the overriding public policy question before the Board.

UP offers two specific proposals. First, although we believe that there are still too many possible permutations to expect parties to address every imaginable combination of Class I carriers and that such an exercise would involve too much speculation, it is not too early to require parties to address in future applications whether a two-railroad North American rail system would be in the public interest. For example, applicants and other parties should address whether a single railroad serving Florida, the Northeast, Western Canada, and California would be manageable and responsive to its shippers. Second, to provide a more realistic analysis of proposals that reach the Board in the same time frame, the Board should announce now that it may consider such proposals in a single, combined proceeding.

UP recommends that the Board replace 49 C.F.R. 1180.1(g) with the following provisions:

(g) *Downstream effects.*

(1) Applicants proposing a major transaction must evaluate the effects on competition and the public interest of combining all Class I railroads in the United States and Canada into two North American Class I railroads. Applicants need not identify specific combinations, but should evaluate the implications of an industry structure consisting of two major railroads.

(2) The Board may, on its own motion or on request of an interested party, consolidate for hearing and decision any application proposing a major transaction filed before the date set for the filing of inconsistent applications in another pending proceeding arising out of another application proposing a major transaction.

II. Maintaining Safe Operations

UP is satisfied that current safety requirements in connection with Class I mergers adequately protect the public interest. The Board's safety compliance programs, developed in conjunction with the Federal Railroad Administration, appear to be effective in ensuring that mergers are implemented safely. The Board should take equal care to ensure that any conditions applied to future Class I mergers can be implemented with similar attention to safety.

III. Safeguarding Rail Service

Service failures following recent major mergers are a primary cause of shipper disaffection with railroads and rail mergers. The Ex Parte No. 582 record rings with shipper complaints about promises unfulfilled and service that declined after mergers. We expect all railroads to propose more stringent measures to prevent future mergers from causing service to decline. Like other railroads, UP proposes more comprehensive implementation planning.

UP believes that railroads proposing future mergers should also accept greater responsibility for effects of their mergers by providing remedies for any significant service deterioration. We believe that the Board has the power to condition mergers in the public interest by establishing an expedited procedure for customers to obtain either temporary substitute service or recovery of substitute transportation costs. Following its 1997-98 service crisis, UP paid hundreds of millions of dollars in such costs to its customers, well beyond its likely liability in the courts.

Remedies must be based on quantifiable and detailed performance data that measure railroad performance in a way that is meaningful to individual shippers. Shippers and the railroads that serve them should be able to compare service before and after a consolidation using consistent measurements.[3] UP proposes that applicants create and maintain databases showing both on-line transit times and on-line cycle times for individual shipments, as well as the extent of variability in each measurement.

UP would also be interested in developing performance measurements for car supply, but we have not been able to identify a way to solve several problems. During car shortages, when the parties most need accurate data, some shippers order more cars than they need to protect their minimum requirements, thereby distorting the railroad's performance. Also, a railroad's ability to satisfy a car order depends on how far in advance the shipper orders the car. Railroads will more frequently fail to fill requests for cars on the same day than requests for cars in three days. UP would be interested in suggestions regarding this performance measurement.

The applicants should be required to develop these data for the base year used in their merger application and compile comparable data throughout the merger implementation period. They should retain all such data throughout the implementation period.

UP proposes an expedited Board procedure to provide effective remedies if, despite all reasonable precautions, service declines significantly after a merger. Customers could request either access by another carrier during the service failure or compensation for reasonable additional transportation costs, such as the cost of moving products by truck.

UP proposes the following addition to 49 C.F.R. § 1180.8:

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3 During its service crisis, UP encountered great difficulty in reconciling its performance data with shipper records. Our proposal solves that problem by requiring comparable data for pre-merger and post-merger periods.

(c) (1) For *major* transactions, provide a detailed implementation plan (exhibit __) explaining how the consolidated entity will perform all of the important actions necessary to implement the consolidation and how it will provide adequate capacity for post-consolidation service. These actions should include at least the following:

(i) labor agreement consolidations;
(ii) computer-system integration;
(iii) significant personnel reductions;
(iv) major reroutes and extended hauls;
(v) capacity expansions and track upgrades;
(vi) acquisition of locomotives and freight cars; and
(vii) facility consolidations and expansions.

Applicants should state the major assumptions underlying the implementation plan. The implementation plan should also set forth the schedule on which public benefits will be achieved. Unlike the operating plan, which is based only on the incremental effects of the consolidation, the implementation plan should accommodate reasonably expected changes in traffic volume that would occur without the consolidation during the implementation period.

(2) The implementation plan should give shippers warning of critical time periods during which service might be affected by major changes, such as computer-system integration. For each major change, the applicants should describe contingency plans and procedures to recover from any service problems that might arise. After consolidation, the combined carrier must update the implementation plan, including the timing of the actions listed in (c)(1)(i)-(vii) above, in quarterly reports to the Board until all of the important implementation actions have been completed. The combined carrier must also transmit notices to potentially affected shippers and other carriers not less than 30 days in advance of implementation actions that might cause disruption, unless circumstances prevent issuing such notices.

UP also proposes the following new section of Part 1180:

1180._ Remedies for service deterioration as a result of consolidation

(a) For the base year, applicants in a *major* transaction must prepare and maintain a database from which it is possible to obtain pre-consolidation (1) transit times and variability of transit times for all shipments; (2) cycle times and variability of cycle times for all applicable shipments; and (3) [supply of empty cars] (collectively, "Service Measurements"). If the consolidation is approved, the combined carrier must maintain this database for five years after the effective date of the Board's decision approving the consolidation, and provide Service Measurements to affected shippers or Class III rail carriers that have a legitimate need for the information in order to demonstrate service deterioration.

(b) The following provisions apply for a period of five years after the effective date of the Board's decision approving the consolidation:

(1) If a shipper (not a third-party beneficiary) or Class III rail carrier that has shipped more than 100 cars over 12 months in a corridor can show that a Service Measurement for its traffic has deteriorated by an average of more than 50 percent from pre-consolidation levels for more than 60 consecutive days, it may give the consolidated carrier written notice asking the railroad to cure service within 60 days from the date of receipt of the notice and to provide historical and current Service Measurements for the affected traffic.

(2) If the carrier is unable to restore service to the 50 percent level by the end of the 60-day cure period, the shipper or Class III rail carrier may file a service complaint with the Board seeking a remedy for inadequate service. To file a service complaint, the shipper or Class III rail carrier must show that the carrier's service, as measured by any of the Service Measurements, deteriorated by an average of more than 50 percent from the base period for 120 or more consecutive days (through the cure period), that it cooperated with the carrier in efforts to restore service, and that it has incurred increased transportation costs as a result of the deteriorated service. Unless the carrier can establish in a reply to be filed within ten days after receipt of the service complaint (x) that the service decline is attributable to factors other than implementation of the consolidation or (y) that the complaining party did not reasonably cooperate with remediation efforts, the Board may grant either of the following remedies within 30 days after the complaint is filed:

(i) temporary access by reciprocal switching or trackage rights (including, if necessary, temporary trackage rights over other carriers) to the complainant's facility, if the Board concludes that access will result in improved service to the shipper and will not adversely affect service to other shippers or further degrade the operations of the consolidated carrier; or

(ii) reimbursement of incremental transportation costs that could not reasonably be mitigated and that were incurred by the complainant or, if complainant is a Class III rail carrier, by shippers located on that carrier.

(3) Pursuant to 49 U.S.C. § 11123, the Board will reconsider the need for the service remedy after 30 days, and the service remedy will automatically expire, if not previously terminated, after 270 days. The consolidated railroad may at any time petition for termination of a service remedy on the ground that service has been restored to the 50 percent level.

(4) If the Board grants temporary access and the railroads cannot agree on compensation, the Board will apply compensation standards under 49 U.S.C. §§ 11102 and 11123.

(5) The entity obtaining access must be a rail carrier with operating authority from the Board, and the Board must determine that such carrier can operate safely to address the service problem.

(6) Remedies are available only to shippers lacking existing rail alternatives; provided, however, that the complainant may seek compensation if it can show that the other serving carriers are disabled by the merger-related service problem.

(7) If necessary to effectuate the temporary access remedy, the Board may temporarily suspend a shipper's contractual duty to ship specified volumes of traffic under rail service contracts with the consolidated carrier. The suspension would apply only for the time period necessary to alleviate the service problem.

IV. Promoting and Enhancing Competition

The Board seeks comment on various mechanisms by which rail merger policy might be used to promote and enhance, rather than simply preserve, competition. Most of these mechanisms address the effects of railroad mergers on so-called "bottleneck segments," which are rail segments that connect shipper facilities exclusively served by one carrier with gateways where that carrier connects with other carriers.[4]

UP does not favor using the Board's jurisdiction over rail mergers to alter the competitive structure of the rail industry other than to address the effects of a merger. UP recognizes, however, that most shippers do not want railroad mergers to affect their

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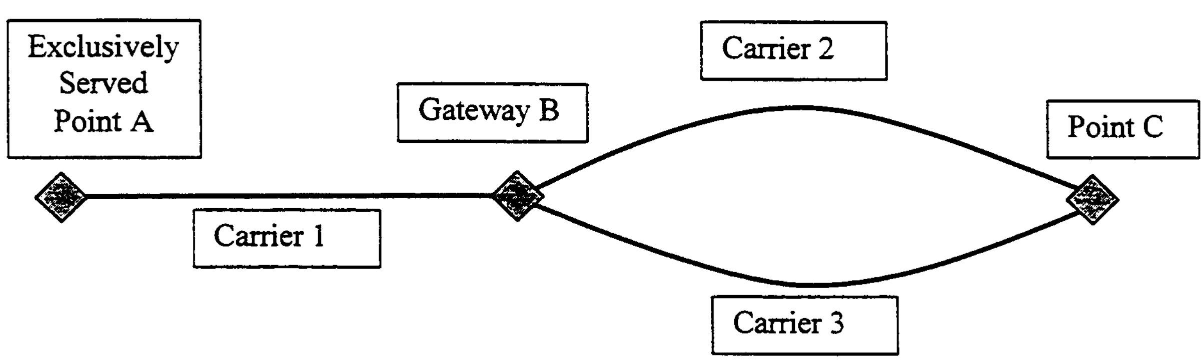
[4] As the Board's March 31, 2000 decision notes, it is well established that the ICCTA generally does not require rail carriers to establish separately challengeable rates for bottleneck segments. The Board's so-called "Bottleneck" rate decisions clarify the specific circumstances under which carriers may be required to establish, and shippers permitted to challenge, bottleneck rates. See Docket No. 41242, Central Power & Light Co. v. Southern Pac. Transp. Co., Decision served Dec. 31, 1996, clarified in Decision served Apr. 30, 1997, aff'd sub nom. MidAmerican Energy Co. v. STB, 169 F.3d 1099 (8th Cir.), cert. denied, 120 S. Ct. 372 (1999); Union Pacific R.R. v. STB, 202 F.3d 337 (D.C. Cir., 2000).

future opportunities to use established interline routing options. Shippers also do not want mergers either to create new bottlenecks or expand existing bottlenecks. Some shippers are concerned that combinations may eliminate competitive routing options that were previously available for the portion of the overall movement between the gateway and either the origin or destination of the traffic – in effect extending the bottleneck segment. Some shippers are also concerned that, where carriers have established separately challengeable bottleneck rates, a combination with another carrier capable of completing the movement could extinguish the shipper's ability to challenge the bottleneck rate.

UP does not share the view of many shippers that end-to-end mergers generally have anticompetitive vertical effects, and the Board must retain the basic economic and legal principles that guided its Bottleneck decisions. Nevertheless, if the nation's rail system is to be restructured into two transcontinental systems, the Board should take action to keep traditional gateways open. Vague assurances that gateways will stay open are not sufficient because there are too many ways to close them commercially.

UP proposes that the Board modify its rules to require combining carriers to make available at a shipper's request separately challengeable bottleneck rates between exclusively served facilities on their system and the predominant pre-merger gateway for the applicable traffic from those facilities. In the classic "rat-tail" diagram set forth below, if



Carriers 1 and 2 combined, they would be obligated, at the shipper's request, to establish a rate for the "bottleneck" segment between exclusively served Point A and Gateway B. This would preserve the shipper's pre-merger options, because the shipper could combine the A-to-B rate with rates offered by Carrier 3 to complete the movement from origin (Point A) to destination (Point C) and, if necessary, challenge the reasonableness of the A-to-B rate. In fact, such a condition would go somewhat beyond merely preserving the exclusively served shipper's routing options. In some cases, as where the traffic is now moving under joint or proportional rates, the reasonableness of the rate between Point A and Gateway B is not separately challengeable today.

The following specific language for a new section in Part 1180 would implement the proposal outlined above:

1180.__ Preservation of gateways and rate challenge options.

(a) A Class I rail carrier participating as a Primary Applicant in a *major* transaction approved by the Board (a "Participating Carrier") shall, upon request of an affected shipper, establish a rate for transportation (a "Segment Rate") applicable to traffic as to which no Participating Carrier served both the origin and destination of the traffic prior to consummation of the transaction (the "Subject Traffic"), between:

(1) any Exclusively Served Shipper Facility, which means any shipper facility (i) other than an automotive distribution ramp, intermodal facility, or transload facility (ii) that is located at any point on the carrier's system served exclusively by that carrier and no other rail carrier (either directly or via reciprocal switching, joint facility or other service arrangement) (iii) where traffic originated or terminated during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction; and

(2) the Pre-Transaction Gateway, which means the point of interchange, if one exists, that during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction, was (i) an actual interchange between the Participating Carrier and two or more other rail carriers, one of which was another Class I carrier participating in the transaction as a Primary Applicant, (ii) the interchange point most frequently used to move the Subject Traffic (or comparable traffic if the rate

would apply to new traffic) between the Exclusively Served Shipper Facility and the origin or destination of the traffic, and (iii) used by at least 100 cars of traffic originating or terminating at the Exclusively Served Shipper Facility.

(b) The shipper at whose request a Segment Rate is established pursuant to this rule shall be entitled to combine the Segment Rate with a rate or rates offered by a carrier other than the Participating Carrier for movement between the Pre-Transaction Gateway and the origin or destination of the Subject Traffic.

(c) The shipper at whose request a Segment Rate is established pursuant to this rule shall be entitled to challenge the Segment Rate as unreasonably high to the same extent and under the same standards as applicable to rate reasonableness challenges under 49 U.S.C. §§ 10701 and 10707. In determining whether the Participating Carrier is "market dominant," the Board will examine whether there is an absence of effective competition on the entire origin-to-destination route, rather than on the segment between the Exclusively Served Shipper Facility and the Pre-Transaction Gateway.

(d) A shipper facility served exclusively by a Class III rail carrier that is incapable of interchanging traffic with any carrier other than the Participating Carrier, or that is obligated by contract to interchange the majority of its traffic with the Participating Carrier, shall be treated as a facility served exclusively by the Participating Carrier for purposes of this rule. If the Participating Carrier lacks authority to establish a Segment Rate between the Exclusively Served Shipper Facility and the Pre-Transaction Gateway, it shall instead establish a Segment Rate between the point of interchange with the Class III carrier and the Pre-Transaction Gateway.

(e) The obligation to establish a Segment Rate shall also apply to any rail carrier (a "Trackage Rights Carrier") that receives trackage rights or other access to the lines of a Participating Carrier as a result of settlement agreements with the Primary Applicants or conditions imposed on the Primary Applicants by the Board. The Trackage Rights Carrier shall be obligated to establish a Segment Rate pursuant to subparts (a)-(d) above only (1) for traffic capable of being handled using the rights or other access granted to the Trackage Rights Carrier and (2) between Exclusively Served Shipper Facilities located on the Trackage Rights Carrier's system as it existed prior to the transaction and the applicable Pre-Transaction Gateway, if any, where such traffic was interchanged, during the twelve months preceding the pre-filing notice under 49 C.F.R. § 1180.4(b) pertaining to the transaction, with the Participating Carrier over whose lines access was granted.

Such a rule would preserve shippers' pre-merger routing and rate challenge options in a straightforward manner that would not unduly constrain the ability of the combined carrier to achieve efficiencies associated with the combination. Because it would make use of existing mechanisms for challenging rates, the merging carriers would be able to estimate the costs of this condition in advance. And the condition would ensure that the major pre-transaction gateways would remain open.[5]

This approach is preferable to the options suggested by the Board:

- The Board's contract option would require the shipper to carry the burden of negotiating an agreement with the non-merging carrier on rates and all other attributes of the transportation. That commercial agreement might not be reached.

- The Board's through route alternative would require the merged carrier and connecting carriers to agree. Again, they might not reach agreement.

- The Board's reciprocal switching and trackage rights proposals would run afoul of the fundamental policy basis for the Board's Bottleneck decisions, which affirmed bottleneck carriers' traditional routing discretion and statutorily-recognized right to select their long-hauls.[6] Those proposals would go far beyond what is needed to offset effects of the merger.

No new rule should require the merged carrier to short-haul itself, depriving the carriers of the returns upon which they depend to attract capital, reinvest in their rail networks, and maintain and improve service.

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5 Our proposed rule clarifies that the existence of transportation alternatives providing effective competition will be evaluated with respect to the entire movement from origin to destination, which is the transportation service of interest to the shipper. This will avoid the anomalous outcomes that would result were market dominance determinations based on competition for the bottleneck segment only, for example where intermodal competition between origin and destination provides a competitive constraint on rail rates but does not exist at a remote rail gateway where there is no reason at all for competition to exist. See, e.g., STB Docket No. 42038, Minnesota Power, Inc. v. Duluth, Missabe & Iron Range Ry., Decision served July 8, 1999 (ignoring rail-truck alternative between coal mine and utility because there was no evidence of transportation competition at interchange point).

6 Docket No. 41242, Central Power & Light Co. v. Southern Pac. Transp. Co., Decision served Dec. 31, 1996, pp. 4-11.

Our rule is also far superior to the long-discredited "DT&I" conditions. Those conditions imposed draconian and inefficient requirements to allow routing over all possible gateways and required rate and service parity regardless of the relative efficiencies of various routes. Any such requirement would create significant impediments to efficiency.

UP's proposed rule would supplement existing precedent governing Board analysis of the potential vertical competitive effects of proposed rail combinations. The Board has not established a hard-and-fast rule that end-to-end combinations can never have anticompetitive effects. Rather, the Board's so-called "one-lump" theory establishes a presumption that end-to-end mergers do not have such effects. The presumption can be rebutted, and shippers can seek additional remedies. See, e.g., Finance Docket No. 32549, BN/Santa Fe, Decision No. 38, served Aug. 23, 1995, p. 71, aff'd, Western Resources, Inc. v. STB, 109 F.3d 782 (D.C. Cir. 1997).

V. Shortline and Regional Railroad Issues

All of the concerns expressed by shortline (Class III) and regional (Class II) railroads (collectively, "smaller railroads") can be addressed by the Board's general rules addressing competition and service issues. The service and bottleneck rate protections set forth in other new rules that UP has proposed would provide significant protections for Class III railroads and the shippers they serve. Additional rules specifically addressing shortline issues are not needed.

In particular, concerns regarding the appropriateness of contractual limits on interchange (sometimes called "paper barriers") are not the proper subject of general merger rules. The underlying contractual obligations did not arise from mergers and often are unaffected by mergers, particularly on UP. Issues relating to such contractual provisions were addressed in Ex Parte No. 575, Review of Rail Access and Competition Issues, and they are the subject of a comprehensive industry agreement negotiated between the Association of American Railroads ("AAR"), on behalf of Class I railroads, and the American Short Line and Regional Railroad Association, on behalf of smaller railroads. AAR has formally invited ASLRA to negotiate regarding that agreement. These issues have also been addressed in individual merger cases on a case-by-case basis.[7]

VI. Employee Issues

UP joins in the Comments of the National Railway Labor Conference.

VII. "Three-to-Two" Issues

UP disfavors any hard-and-fast assumption that anticompetitive effects arise only when the number of rail carrier alternatives drops from two to one. UP believes that the Board should clarify that it will not constrain its analysis of the competitive effects of future transactions in this manner. In past cases, the Board has recognized the potential competitive effects of proposed combinations that reduce the number of rail carrier alternatives from three to two, such as where the combination involves the shippers' two most efficient alternatives.[8] The Board can assess the competitive effects of any proposed transaction only by considering the individual circumstances of each situation.

The Board should therefore consider the following new rule, which could be inserted at the end of 49 C.F.R. § 1180.1(c)(2)(i):

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7 See also Finance Docket No. 33388, CSX/NS/Conrail, Decision No. 89, served July 23, 1998, p. 77.

8 See, e.g., Finance Docket No. 32760, UP/SP, Decision No. 63, served Dec. 4, 1996 (explaining the need for conditions to preserve competitive options for shippers at Lake Charles, Louisiana, served pre-merger by UP, SP and KCS, because of circuity in KCS's route structure).

> The Board will evaluate on a case-by-case basis all claims that a proposed transaction would adversely affect competition by reducing the number of rail carrier alternatives serving an individual shipping point, an origin-destination corridor, or some other properly-defined transportation market. In evaluating such claims, the Board will not apply any rigid numerical standard based on the number of rail carriers serving the market before and after the transaction. Rather, the Board will examine all of the circumstances relevant to the competitive effects of the transaction, including such factors as the nature of the transportation service at issue; the effectiveness of the competition provided by each of the rail carriers serving the corridor, point or market; constraints on rail rates from intermodal, geographic or product competition; and the transaction's effects on the strength of competition among the serving rail carriers.

VIII. Merger-Related Public Interest Benefits

UP recommends that the Board establish a higher threshold for claims of merger benefits. The Board's existing rules indicate that it will "consider whether the benefits claimed by the applicants could be realized by means other than the proposed consolidation that would result in less potential harm to the public." 49 C.F.R. § 1180.1(c). In practice, however, the Board has been reluctant to find that particular claimed merger benefits could be achieved by means other than merger.[9] Recent changes in the structure of Class I railroads, advances in technology, and various innovations in cooperative relationships among rail carriers have made it much more likely that categories of public benefits historically associated with railroad combinations can be achieved via other means. These include:

- Alliances among connecting carriers, such as the KCS-CN-IC alliance;

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9 See, e.g., Finance Docket No. 33556, CN/IC, Decision No. 37, served May 25, 1999, pp. 46-49; Finance Docket No. 32760, UP/SP, Decision No. 44, served Aug. 12, 1996, pp. 109-13.

- Industry initiatives, such as AAR's "Interline Service Management" program, which expects to resolve remaining data exchange issues this summer;
- Operational coordinations, such as CN and CP's recent agreement on directional running in British Columbia and the efforts currently underway to streamline operations in the congested Chicago terminal;
- Service initiatives, such as the recently announced NS-BNSF transcontinental intermodal trains; and
- Potentially revolutionary changes in railroading as a result of "business-to-business" e-commerce.

All hold the potential for achieving many of the types of public benefits that historically have been associated with railroad combinations.

Mergers should not be credited with benefits that are practicably achievable through other means that would not cause irreversible changes in the structure of the railroad industry. Indeed, mergers may impair benefits achievable through alternative arrangements. For example, the KCS-CN-IC alliance probably will be lost if BNSF and CN merge.[10] Accordingly, the Board should modify its rules to clarify that it will treat as public benefits only those benefits that can practicably be achieved only through mergers.

UP proposes replacing the last sentence of 49 C.F.R. § 1180.1(c), immediately preceding sub-part (1), with the following:

> The Board will treat as public benefits only those improvements in cost, efficiency, service, competitiveness, or other benefits that applicants demonstrate are incremental to the benefits that could practicably be achieved through means other than a major transaction. The Board will also consider whether, as a result of the applicants' pursuit of the proposed transaction, any improvements in cost, efficiency, service,

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[10] At the Ex Parte No. 582 hearing, Michael R. Haverty, President and Chief Executive Officer of the Kansas City Southern Railway predicted that, if BNSF and CN combine, "We do not feel that long term the CN-IC-KCS marketing alliance is going to survive."

> competitiveness, or other benefits that would likely be achieved without the transaction would be reduced or lost as a result of the proposed transaction.

IX. Cross-Border Issues

UP believes that the Board should clarify two aspects of its rules as they relate to potential combinations involving non-U.S. carriers.

First, the Board's rules should explicitly acknowledge the extensive relationships among all aspects of the North American rail network by requiring, in the case of a proposed combination involving a carrier within the Board's jurisdiction that has foreign operations, that applicants submit with their application the same information for the foreign service as would be required if the participating carriers operated wholly within the United States. The Board cannot effectively carry out its obligation to evaluate whether a proposed Class I combination is in the national public interest unless it is able to evaluate all aspects of a transaction that affect the United States.

Because of the network characteristics of the railroad industry, changes brought about by a combination that directly affect one part of a railroad system can have significant indirect effects on other parts of the system or, indeed, on the entire North American rail network. This interrelationship was borne out clearly in connection with UP's 1997-1998 service difficulties, when congestion in the Houston area led "to a lengthy and damaging service breakdown dramatically affecting rail transport throughout the West."[11]

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[11] Finance Docket No. 32760 (Sub-No. 26), UP/SP Houston/Gulf Coast Oversight, Decision No. 10, served Dec. 21, 1998, p. 6.

The same is true with respect to the competitive impacts of a proposed transaction. Because huge volumes of Canadian-originating rail traffic move into the U.S.,[12] transactions that affect competitive alternatives in one part of the continent – in one province of Canada, for example – may have an impact on U.S. interests.

Given these interrelationships among all parts of the North American rail network, the Board and other interested parties participating in a merger proceeding cannot be assured of having access to all the information needed to protect the public interest unless the applicants treat their proposed transaction, for purposes of the analysis to be performed by the Board, as if it were occurring entirely within the United States. Applicants should be required to submit to the Board a system-wide operating plan and a system-wide implementation plan. Applicants should similarly be required to address in their application all the competitive effects of their proposed combination, including effects that might seemingly involve competition outside the United States. Applicants should also address the potential effects of public policies in the foreign jurisdiction on U.S. rail service and viability.[13]

UP recommends that the Board's rules be clarified by adding the following new subsection 1180.6(d):

> In major transactions involving carriers with foreign operations, the information required to be included in the application by this section and sections 1180.7, 1180.8, and 1180.9 shall address the entire transaction and all of its

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12 For example, more than 80 percent of British Columbia Railway's traffic flows into the United States.

13 For example, the Canadian government recently ordered CN and CP to reduce grain rates by 18 percent. If applied to all traffic, such policies could impair the viability of the Canadian portion of a combined rail system.

impacts, including competitive impacts, operating changes and financial effects outside the United States.

Second, it is well established that the Board has broad power to impose conditions designed to mitigate adverse effects of the proposed transaction by indirect means if necessary. For example, the Board can require applicants to enter into agreements with third parties that remedy adverse consequences of their proposed transaction even where the Board itself could not impose upon the applicants the relief embodied in the agreement.[14] The Board's rules should make clear that the Board will impose conditions to remedy potential adverse consequences of transactions involving foreign operations, even where jurisdictional limits on the Board's authority may preclude the Board from granting relief directly. If necessary to make such conditions enforceable by the Board, the Board could require that applicants consent to Board jurisdiction with respect to disputes concerning compensation or other aspects of the conditions the Board imposes.[15]

UP proposes that the Board clarify its rules in this regard by adding the following language to the end of section 1180.1(d)(1):

> In *major* transactions involving carriers with foreign operations, the Board may impose conditions to ameliorate potential adverse effects arising outside the United States. The Board may, for example, as a condition to approving the application, require applicants to enter into legally enforceable private agreements that would remedy potential harms.

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14 See, e.g., Finance Docket No. 32760, UP/SP, Decision No. 44, served Aug. 12, 1996, p.146 (requiring UP, as condition of consummating proposed acquisition of SP, to modify contracts with shippers at 2-to-1 points to allow BNSF access to at least 50% of volume).

15 Agreements entered into to carry out conditions imposed by the Board are routinely enforced by the Board notwithstanding that similar agreements among carriers that do not stem from Board-imposed conditions would be outside the Board's jurisdiction. Canadian Pac. Ltd. v. United States, 379 F. Supp. 128, 133 n.12 (D.D.C. 1974).

CONCLUSION

UP believes that this proceeding is among the most important to come before the Board since the Staggers Act. The rules and policies established here will shape the future structure of the railroad industry and may determine whether the industry grows or atrophies. UP will continue to participate with those high stakes in mind.

Respectfully submitted,

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May 16, 2000

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 16th day of May, 2000, a copy of the foregoing "Union Pacific's Comments and Initial Proposals" was served by regular mail, postage pre-paid, or a more expeditious manner of delivery on all parties and non-parties of record to this proceeding.

J. Michael Hemmer